Dick Davidson
Chairman

July 15, 2005

The Honorable Roger P. Nober
Chairman
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

Dear Chairman Nober:

Union Pacific Railroad Company submits this response to your June 15, 2005, request for information about Union Pacific's plans for the fall peak shipping season. As we have with all major communications that inform our customers about our plans and progress, we will post this letter on Union Pacific's website.

Our responses to your requests follow.

- **"The steps UP is taking to ascertain demand for, and to prepare for, the fall peak."**

As we explained last year, Union Pacific develops detailed forecasts of transportation demand and updates those forecasts at least quarterly. We prepare and update our forecasts based on frequent and detailed communications with customers about their anticipated shipping needs. We also consider public and private forecasts of economic indicators, as well as changes in shipping patterns caused by fluctuations in the national and international economies.

Demand for rail transportation service remains strong. Union Pacific handled a record number of carloads in 2004. We anticipate a one to two percent increase in carloads during 2005, setting another record.

Union Pacific expects to handle this fall's peak demand more effectively than it handled 2004's. We are doing our best to prepare for it by adding substantial numbers of transportation employees, operating managers, locomotives, and cars and by investing in the railroad at a record clip. Nevertheless, continued strong demand for rail services is pressing the limits of our capacity in several areas and stressing our system.

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- **"UP's performance goals for at least the next 120 days, with a view toward meeting the service demands for the fall peak."**

Union Pacific continues to focus on improvement in performance as measured by key metrics. The most important of these are average system velocity, terminal dwell time, and total car inventory. Velocity has been flat in recent months, significantly affected by difficulties in the Powder River Basin. We have sustained improvements in terminal dwell and reduced inventory. We believe that the steps and programs outlined below will continue to improve our performance and will allow us to meet peak demand for all commodities except Powder River Basin coal.

- **"UP's plans for achieving those goals."**

In 2004, Union Pacific faced crew shortages and needed additional locomotive power. Our aggressive hiring and training programs addressed the crew shortages, bringing aboard some 5,000 new train service employees in 2004. We continue to build the ranks of locomotives engineers. We also continue to hire additional train and engine employees. For the peak period of August through November this year, we expect to have nearly 1,500 more train and engine employees trained and qualified than we had during the same period in 2004.

We have continued to buy locomotives to deploy a modern, fuel-efficient fleet. Union Pacific acquired approximately 315 new locomotives in the first seven months of 2005. We expect to have approximately 300 more locomotives in service during this year's peak period than we did during the 2004 peak-shipping season. We are also acquiring through purchase or lease the equivalent of approximately 4,000 freight cars in 2005.

At least as significant as our additional employees and locomotives are the operational changes and capital investments that Union Pacific is making in this capacity-constrained environment. We are implementing a redesign of our network, the Unified Plan, to improve service reliability. We also are expanding our use of industrial engineering methods to maximize our performance in terminals and on certain segments of the railroad. Finally, we are targeting capital investments to enhance capacity.

1. **<u>Unified Plan and Other Operating Changes</u>**

Union Pacific is well along and on schedule in implementing its Unified Plan. When fully implemented, the Unified Plan should improve system velocity through a 10 to 15 percent reduction in mainline work events and a three to six percent reduction in switching at terminals. The plan also generates additional network capacity and improves productivity through better asset utilization.

Implementation began in April, when we instituted a redesign of automotive services. That auto component alone yielded a 15 percent increase in capacity at Union Pacific's

Bailey Yard in North Platte, Nebraska, the nation's largest freight yard. Several other phases have been implemented since then. As of July 1, the Unified Plan had eliminated over 1,000 switching events and 50 mainline work events. Improvements in the manifest network have reduced terminal volume at Topeka and Parsons, Kansas; our Kansas City yards; Hinkle, Oregon; and Livonia, Louisiana. System terminal dwell is down by ten percent.

Union Pacific recently implemented the Heartland, MidAmerica, and Mexico phases of the Unified Plan. These phases changed traffic flows and blocking assignments throughout the central part of the country, from St. Paul, Minnesota, to Laredo, Texas, and from North Platte, Nebraska, to Houston, Texas. These phases affected thirteen terminals and numerous corridors and manifest trains, eliminating more than 700 intermediate car handlings and 38 work events.

The Unified Plan includes major changes to our intermodal network as well. At the end of this month, UP will start implementing its Chicago intermodal strategy. We will assign certain terminals in Chicago to handle only domestic traffic, while others will handle only international business. For example, our Global Two terminal in Chicago will handle only international containers, while Global One will handle domestic containers. These changes will allow Union Pacific to operate single-destination intermodal trains between West Coast terminals and Chicago-area terminals, eliminating intermediate stops. We expect these actions to result in 44 percent fewer mainline work events in the Chicago area, which have congested our busy Chicago line. We also will improve utilization of freight cars designed to carry international or domestic containers. Intermodal customers affected by this change have been involved and kept informed.

In addition to the Unified Plan, UP has taken numerous actions to improve operations in two terminal areas where our service has struggled, the Los Angeles Basin and Houston. In the Basin, we opened a supplemental auto ramp at Marne (near City of Industry), increased directional operations, added capacity at our East Los Angeles and ICTF facilities, reduced work events, increased our ability to respond to incidents (such as locomotive failures), implemented a new Customer Information Management System (CIMS), and added management positions. We will open a new locomotive shop at West Colton Yard during the fourth quarter of this year.

In Houston, we reduced operating conflicts by expanding directional operations, increased our incident-response capacity, added managers, committed more locomotives, implemented CIMS, and adopted operating practices that sharply reduced blocked crossings in Houston.

2. Industrial Engineering

Union Pacific has expanded its in-house industrial engineering capability and applied Toyota's Lean management techniques to improve operations. The Lean process focuses on opportunities to increase velocity and efficiency by reducing movements, inventories, defects, and rework. This process has been applied in a number of locations.

For example, we used the technique to enhance the fluidity of our Sunset Route between El Paso, Texas, and Colton, California. On that route, our Lean teams established uniformity in assigning locomotive horsepower and dispatching practices. Equipment restrictions were applied to limit equipment that could not be moved at track speeds. Finally, incident-response teams were deployed so that we can quickly address impediments to the efficient flow of trains and traffic, such as locomotive failures or track defects.

Other Lean projects focused on improving terminal operations in El Paso, Tucson, and Phoenix, some of the fastest growing cities in the U.S. (Reportedly more than 30,000 people per month move into southern Arizona, all needing homes and transportation infrastructure.) In cooperation with our customers, we improved management of car inventories and the reliability of local switching. Processes were developed to anticipate demand so that customers can manage their shipments more effectively, avoiding congestion. Consequently, car inventory has declined, terminal dwell has declined, and service to our customers has improved. (We also added a tri-weekly through train from Portland to Phoenix, reducing transit time by many hours and releasing yard capacity.)

The success of this project is confirmed by improved velocity over the corridor, more trains, fewer recrews, and improved local switching. Our Lean teams are now working in Houston and the Los Angeles Basin, where we expect to achieve similar successes.

3. Coal Transportation

Union Pacific's plans for peak-season coal transportation have been frustrated by developments in the Powder River Basin. BNSF and Union Pacific serve the mines in the Southern Powder River Basin via a jointly-owned line that is maintained and dispatched by BNSF. Two derailments in mid-May, following heavy snow and rains, demonstrated that the buildup of coal dust on the Joint Line--which the Board saw in 2004--crippled the railroad. Coal dust in the roadbed prevents water from draining out of the ballast and destroys the ballast's ability to support the track structure. As a result, concrete ties fracture, rails spread apart, and switches suffer damage. BNSF spent more than a month making emergency repairs to keep the railroad running. A long-term maintenance program to clean the ballast and rebuild the railroad has begun and will continue until cold weather halts it in November.

These developments have had a significant effect on Union Pacific's ability to meet demand for Wyoming coal. We are telling our customers to expect to receive about 80 to 85 percent of the tons they had estimated, although we and BNSF have been loading a somewhat higher percentage thus far in July. Based on current market demand, UP is entitled to, and now is receiving, about 54 percent of the available loadings from Joint Line mines. Unfortunately, mine breakdowns have further limited the number of loads, as UP has lost about 40 loads due to mine limitations so far this month.

We have kept our customers apprised of developments and encouraged them to manage their coal supplies carefully. We will be allocating available coal capacity among existing contract and common-carrier customers as equitably as possible. We may be able to make up some of the shortfall when winter weather halts the major track projects on the Joint Line, but additional track work may be necessary in 2006. As BNSF and UP continue to add capacity on the Joint Line and as BNSF completes the rehabilitation work, the shortfall should ease.

Union Pacific has thus far met demand for Colorado and Utah coal, but with little room to spare. Some of the mines have suffered from production problems, including a fire in one of the mines. We have little opportunity to make up missed loadings or add additional shipments.

- **"UP's capital plans for increasing capacity in 2005."**

Union Pacific's capital investment plan for 2005 is our largest in history. Counting long-term leases of locomotives and freight cars (we use these leases in lieu of purchases), we will invest $2.8 billion in the railroad, which is over 20 percent of our expected revenue. This sum includes about $288 million in additional rail line and yard capacity and $220 million in new commercial facilities. We are spending over $1.3 billion to maintain the railroad. We generally are on schedule to complete these investments.

Our capacity plans for peak season include dozens of individual projects, the most important of which are:

- Sunset Route. We are adding 68 additional miles of second main track on the El Paso-Colton line, with 28 miles already in service.

- Central Corridor. We placed 63 miles of Centralized Traffic Control in service in western Iowa. We added high-speed cross-overs at various locations and improved our yard at Beverly, Iowa, near Cedar Rapids. We constructed additional set-out tracks at North Platte to expedite repair of coal cars and plan additional improvements there. We are also adding high-speed cross-overs in Wyoming.

- Salt Lake City-Los Angeles. We rebuilt a substantial part of this line in Nevada after a winter storm washed it out earlier this year. We are now extending two sidings, while a third awaits environmental permits. These will allow us to operate longer trains from the L.A. Basin.

- Powder River Basin. With BNSF, we have opened an essential section of third main track at the south end of the Joint Line and are expediting design of another section further north.

- Colorado Coal. We completed a new siding at Whitewater, Colorado, increasing coal-hauling capacity on our North Fork Branch.

- Arizona. We built three new yard tracks and an additional team track in Phoenix. We added yard trackage at Campo and Mesa, southeast of Phoenix. One siding will be extended and another siding constructed between Tucson and Nogales for growing traffic over that Mexican gateway.

- Los Angeles Basin. We are improving our yards at East Los Angeles and at Delores (near the ports).

- San Antonio. Extensive reconstruction of San Antonio trackage and yards is in the planning and preliminary construction stage, including additional double track, a new rail line to a new Toyota auto plant, improvements to yards, and additional connections. Our maintenance plan includes major track work in this area.

- Other Texas projects. Our many Texas projects include yard and signal improvements in Big Spring and Ziler between El Paso and Ft. Worth, new main lines bypassing Centennial Yard in Ft. Worth, additional double track in Ft. Worth, and a siding extension and signal upgrades between Houston and Brownsville.

- Oklahoma. Two new sidings have been added between Muskogee and Ft. Worth, and improvements will be made at Muskogee Yard.

- Kansas City. We increased capacity in Armourdale Yard in order to process more run-through coal trains, added signals on the River Subdivision east of Kansas City, and added crossovers that smooth operations through busy Rock Creek Junction in northeast Kansas City.

- Illinois. In Southern Illinois, we will extend a siding at Salem (a major interchange point with other railroads) and have added three new sidings for coal traffic, as well as power switches on a coal line.

Our investments in commercial facilities include two major projects:

- Dallas. We are constructing a major intermodal terminal at Wilmer, southeast of Dallas, at a cost of almost $90 million. It will begin operation during the third quarter of 2005.

- Salt Lake City. We are constructing a new intermodal terminal and expanding our automotive ramp at a cost of almost $100 million. Some of the funds will come from public sources, in exchange for UP rail lines that will be used for commuter service. The intermodal facility is scheduled to begin operations by the end of the year.

- **"Identification of UP's critical capacity-related infrastructure needs."**

Among the major railroads, UP has invested more than any other, especially to rebuild deteriorated MKT, C&NW and SP infrastructure. As already noted, this year's level of capital investment will be the highest in our history. Our substantial 2005 capital plan addresses our most critical infrastructure needs.

If demand for rail transportation continues to surge, however, Union Pacific foresees additional capacity challenges, although we also view them as potential opportunities. Our ability to invest in infrastructure to meet growing demand will depend on whether the marketplace, our own efforts, and government actions permit the company to achieve sufficient earnings.

Our Sunset Route between El Paso and Los Angeles illustrates the situation we face. As we have told investors and the Board, demand for service on this route already exceeds capacity. We are investing in second main track to add capacity at a measured pace. We would like to build capacity more quickly, but earnings from the traffic we carry over the route do not yet justify greater investment.

Union Pacific foresees the following capacity needs in future years:

- Coal lines. As noted above, we are currently unable to satisfy the demand for coal transportation due to maintenance problems on the Joint Line. Meeting the longer-range needs of our coal customers, whose demands are increasing rapidly, and responding to new market opportunities in the East will require substantial investments. In coming years we will need more coal capacity on our east-west main line between Gibbon, Nebraska, and Chicago; on the former Rio Grande in Colorado; on our North Fork Branch in western Colorado; and between Kansas City and St. Louis.

- Central Corridor. Coal is not the only growing traffic on our Chicago-Ogden, Utah, route. Other types of traffic are growing as well, including surging international imports though West Coast ports. In addition to investments that are underway on the eastern part of the Central Corridor, our main line in Wyoming will require additional investment, which we began this year by installing new cross-overs.

- Southern California routes. In addition to the Sunset Route, Union Pacific's alternative route from Southern California through Las Vegas has capacity limits, which explains the siding extensions in this year's capital plan. Within the Los Angeles Basin, we will soon need to add second main track on both of our east-west routes. Our Ft. Worth-El Paso line already requires continuous capacity growth to handle Southern California traffic. Several years from now, assuming import growth predictions are accurate and returns on investment permit, we will need to add capacity east of El Paso on our lines to Houston and Kansas City.

- Other segments nearing capacity. Several of our routes in the Houston area will need more capacity. For example, we have little room for additional trains on our line between Houston and Brownsville without capacity improvements. That route urgently needs new capacity on the BNSF segment that we must use between Alvin and Algoa, Texas. We may need additional infrastructure on other routes in Central Texas to meet the needs of rock shippers.

- Terminal areas. We are adding to and reconstructing rail infrastructure in several large cities, where investment in infrastructure was not justified for many years due to inadequate returns on investment. We began this effort in rapidly growing Phoenix, Tucson, El Paso, and San Antonio, as described above. We are looking hard at Houston infrastructure now (in consultation with BNSF, KCS, and public officials), and we likely will need to invest more not only in the Los Angeles Basin, but also in Las Vegas and Chicago, to name a few.

- Facilities. As intermodal and other types of traffic continue to grow, we will approach the capacity of some of our intermodal and automotive ramps. We may also need to add transloading facilities to handle additional carload traffic.

The nation faces important public policy questions as rail capacity fills. A rail study performed by the American Association of State Highway and Transportation Officials (AASHTO) predicted a few years ago that the railroad industry was on a vector by 2020 to fall $53 billion short of its capital needs merely to handle growth in existing traffic. If only directionally, that prediction is coming to pass. Railroads need to earn higher returns in order to fund greater levels of capital investments for the growth that appears to be coming.

Those who argue for more government regulation in order to reduce rail rates ignore this reality and would undermine their own long-term interests. The notion that railroads can add more traffic at lower rates and, as a result, justify greater investment makes no sense when current traffic fills capacity in many areas and current rates fail to justify more investment. Lower rates would reduce investment, reduce rail service, and leave more shippers without a viable rail option in the future.

- **"UP's plans for addressing those critical capacity-enhancing infrastructure needs and UP's expectation for timely completion of those improvements."**

Some additional capacity will be created as key network management and industrial engineering initiatives are implemented. In addition, we expect to invest in new capacity as returns on investment justify, given the revenues we are able to earn in the marketplace and the constraints that government actions place on them.

- **Plans for communicating this information to customers.**

This letter will be placed on our website. Union Pacific has consistently reported its performance and plans through customer letters on its website and through direct contacts with customers. We have held customer forums in areas where the need has been greatest. We have been frank and accurate in our communications about recent problems in the Powder River Basin. We will continue to communicate throughout peak season.

Sincerely,

Dick Davidson

Copies:
Vice Chairman W. Douglas Buttrey
Commissioner Francis P. Mulvey